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# CHICAGO-KENT LAW REVIEW

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SYMPOSIUM EDITOR  
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## ARTICLES

- UNIFORMITY AND DIVERSITY IN  
PAYMENT SYSTEMS *Clayton P. Gillette* 499  
*and Steven D. Walt*

The rules governing the transfer of value between users of payment systems differ among payment systems. Rules allocating loss from unauthorized payment, erroneous payment, and the reversibility of payment vary according to whether payment is made by check, credit or debit card, wholesale wire transfer, or letter of credit. Thirty-five years after the New Payments Code failed to attract enough support to become law, academics and practitioners recently have proposed that payment system rules be uniform. This Article rejects this initially attractive position. It argues that the optimal standardization of payment system rules allows diverse rules among payment systems. The case for uniformity implicitly judges the reduction in information costs resulting from standardization to exceed the benefits from a choice among payment instruments with different rules. The Article argues that the proponents for uniformity overestimate the savings in information costs and ignore or underestimate the benefits to payment system users of different rules governing payment instruments. The technology for transferring value and predominant use of particular payment instruments differs, as does the capacity of payment system users and providers to avoid or reduce loss. Even cognitive error or unawareness of payment system rules among consumers does not always justify a single consumer-specific rule for consumer payments. While current law does not necessarily offer optimal diversity, diverse rules among some payment systems would be preferable to uniformity.

REIMAGINING PAYMENT SYSTEMS:  
ALLOCATION OF RISK FOR  
UNAUTHORIZED PAYMENT INCEPTION

*Linda J. Rusch* 561

Payment systems have evolved as new mechanisms for transferring value have been created. The legal infrastructure supporting those mechanisms has evolved in a piecemeal fashion resulting in very different risk allocations depending upon the mechanism used to transfer value. This article argues that the time has come to revise payments law to address the risk allocation issues in a direct fashion based upon uniform policy positions, regardless of the mechanism used to transfer value. To illustrate that concept, an approach to drafting statutory language for drafting allocation of risk from unauthorized payment inceptions is proposed.

UNAUTHORIZED PAYMENT TRANSACTIONS  
AND WHO SHOULD BEAR THE LOSSES

*Francis J. Facciolo* 605

This article is concerned with how losses should be allocated between holders of accounts that are implicated in payment systems and the financial institutions that participate in the payment systems by acting as intermediaries between account holders. The rules involving payment systems show a wide range of divergent approaches. In the period before a transaction is executed, some payment systems take the possible negligence of an account holder into account in allocating losses for unauthorized payment transactions. The checking system is the classic case. In contrast, the Truth-in-Lending Act and the Electronic Fund Transfer Act both ignore the negligence of an account holder prior to the unauthorized transaction. This article suggests that the issue of who can police unauthorized payment transactions has become entangled with a series of technical issues about which many lawyers have little knowledge. What we should be seeking is a set of principles for payments law that are not dependent on the current state of technology. This article argues that the technology has exceeded the ability of most people to understand or control it, that this fact is unlikely to change, and that the complexity of technology will just keep increasing. In addition, it argues that the sheer quantity of information concerning payments that an account holder must process has grown tremendously. Both of these sets of facts suggest the financial institutions that participate in the payment systems should police them, including preventing unauthorized transactions. Payments law should not rely upon account holders, who can be too easily overwhelmed, to be effective monitors of unauthorized transactions.

PAYMENT FINALITY AND DISCHARGE  
IN FUNDS TRANSFERS

*Benjamin Geva* 633

The article explores the occurrence of "final payment" in funds transfers in the form of "accountability" by a bank instructed to pay to a payee/beneficiary. Both the accountability of the drawee/payor bank in a check-collection debit-pull system and that of the beneficiary's bank in a wire-transfer credit-push system are discussed. The article further examines the relationship between "final payment" and the discharge of an obligation paid by means of the "funds transfer." It analyzes relevant provisions of Articles 3, 4, and 4A of the Uniform Commercial Code, sometimes against the background of general common law principles. The article proposes minor statutory amendments, and also points out a possible improved bank mechanism consisting of a bank check paid by means of a wire transfer. Such mechanism is designed to meet regulatory concerns, as well as to enhance speed and flexibility for a discharge in connection with a payment that is either required to coincide with the occurrence of external conditions or is otherwise time sensitive. While concluding that the various components of the U.C.C. scheme that governs the subject are fundamentally sound, the article recommends the pursuance of a law reform project leading to a statute dealing with both "finality of payment" and discharge across all categories of payment systems.

"Final payment" occurs when a payee acquires ownership of the money paid, so that payment can no longer be revoked by the payor or recovered by self-help. But final payment in this sense is not the end of the story, because a person who has made a payment as a result of fraud or mistake has a prima facie claim in restitution to get the money back. "Final payment" is therefore the point at which restitution begins. Finality in a different sense—meaning the point at which a payee is protected from a liability in restitution—is determined by standard affirmative defenses, most notably the rule of *Price v. Neal*. Confusion between the two kinds of finality distorts payments law and leads to errors—either too much restitution or not enough—in a number of settings, some of them diverting.

# UNIFICATION OF PAYMENTS LAW AND THE PROBLEM OF INSOLVENCY RISK IN PAYMENT SYSTEMS

James Steven Rogers 689

The law of payment systems is currently quite fractionalized. Different legal regimes apply to different payment systems, although the differences among the systems are obscure to the ordinary user. This article considers some aspects of the question whether unification is feasible. The discussion begins with some general issues, such as whether it makes sense to frame the issue as whether payment systems should be "regulated," or whether all rules for different payment systems should be uniform. The discussion then turns to one specific issue: who should bear the risk of insolvency of payment system providers? Private law cannot eliminate the risk of provider insolvency. A person who maintains an account with a given institution necessarily accepts the risk of that institution's solvency. The question is what to do if insolvency of some financial institution prevents completion of a payment transaction. On that question it seems entirely feasible to adopt a general principle that the risk of intermediary provider insolvency is borne by the providers of the payment system, not by the users of the payment system.

# DUTY ISSUES IN THE EVER-CHANGING WORLD OF PAYMENTS PROCESSING: IS IT TIME FOR NEW RULES?

Sarah Jane Hughes 721

As payments systems proliferate and become increasingly dependent on the electronic transmission of data or images to the bank that represents the obligor, obligors have lost control over the systems of laws that govern their payments transactions. This article forecasts a trend away from the common law approaches of measuring the behaviors of payments intermediaries—depository banks and payor banks as well as systems such as the automated clearing houses—by means of the concepts of "good faith" and "ordinary care," long staples of payments under the Uniform Commercial Code, in favor of brighter-line standards such as those that the National Automated Clearing House Association (NACHA) and the Electronic Check Clearing House Organization (ECCHO) adopted in their operating rules. It also argues for retention of the good faith and ordinary care standards where appropriate. The article suggests that four organizing principles should guide the norms for payment systems rules going forward: transparency (the ability of a consumer or small business to appreciate which set of payment rules will govern disputes about a payment transaction), consistency (the current wide variation in rules governing dispute resolution), proof (the difficulty, particularly for consumers and small businesses, of proving who, among many intermediaries, caused a particular problem), and privity (the problems faced in court actions by obligors who are not in privity with the person(s) who caused the problem). It also urges that harmonization of the rules would assist consumers and small businesses in managing problems arising out of payments.

COMMENTARY: WHERE IS THE ECONOMIC  
ANALYSIS OF PAYMENT LAW?

*Joseph H. Sommer* 751

Modern payment law began precisely a quarter of a millennium ago, when Lord Mansfield decided *Miller v. Race*. After 250 years, we know little more than Mansfield, even with the analytic power of modern neoclassical microeconomics. Many of the simplest questions have no easy answer: What is a payment? (The U.C.C. has no definition.) What is payment finality, and why is it important? (There is no consensus, especially because payment finality was law long before bankers discovered its connection to systemic risk.) What is the normative rationale of the clearing and settlement rules in the U.C.C.? (Again, no consensus, and not even much commentary.) What is the proper scope of payment law? (Explain why U.C.C. Article 5 is in most payment casebooks, and the law of suretyship is not.)

Neoclassical microeconomics has been a general success in business law: a facile framework for difficult legal problems. But it has not worked in payment law, with a few exceptions such as the allocation of risk for fraud and mistake. Is there a reason for this? Read this commentary to find out.

BEFORE THE GRAND RETHINKING:  
FIVE THINGS TO DO TODAY WITH  
PAYMENTS LAW AND TEN PRINCIPLES  
TO GUIDE NEW PAYMENTS PRODUCTS  
AND NEW PAYMENTS LAW

*Gail Hillebrand* 769

This article describes the incomplete consumer protection and illogical results now occurring from the application of current federal consumer protection law to a broad variety of types of payments products used by individuals that were developed long after the relevant federal laws were written.

The lag in payments law has real impacts on consumers. The adverse consequences include the mistaken assumption of rights that do not exist; individuals losing of control of their checking accounts; and that the consumer's rights may depend upon the choices made by merchants, processors, and banks. Surprisingly, the most fiscally dangerous payment choice for an individual—the credit card—is the one with the best consumer protections. Individuals who carry a credit card balance, however, face a much higher cost to obtain those protections than those with the economic cushion to pay off their balances every month.

This article proposes a baseline level of consumer protection for all existing and new payments mechanisms used by individuals. This includes credit and debit cards, checks, non-card payment devices such as the cell phone, and emerging payments methods such as placing a charge on a services account bill, such as a phone bill. To create this protection, the article proposes specific statutory changes to the Federal Electronic Fund Transfer Act, the Fair Credit Billing Act, and the Expedited Funds Availability Act, plus expanded use of financial institution regulators' power to restrict unfair and deceptive trade practices. The article further offers a set of ten principles by which payments providers, legislators, regulators, and consumers should judge new payments mechanisms.

CONFUSION AND CONVERGENCE IN  
CONSUMER PAYMENTS: IS COHERENCE  
IN ERROR RESOLUTION APPROPRIATE?

*Anita Ramasastry* 813

At present, there are no uniform rules governing retail payment systems in the United States. Checks, credit cards, debit cards, and new types of payment systems—such as stored-value cards and prepaid cards—are governed by different rules and provide consumers with varying protections. In addition, several phenomena may have confused consumers about the type of consumer protections they have when using different payment systems. First, new types of intermediaries have developed—such as online funds transmission and electronic

bill presentment and payment—that piggyback on existing payment systems. Second, electronic check conversion systems may convert customer checks into a different payment system—electronic funds transfers. Third, new types of payment methods—such as stored-value cards—are not subject to regulation in many instances. This article explores whether there is a benefit to uniform rules for different payment methods, the possibility of harmonization of error resolution procedures, and why harmonization may be an efficient and effective way to prevent and detect error. This article also advocates that, in the absence of uniform Federal procedures, individual states should apply prudential regulations to pre-paid cards and stored-value cards as a means of ensuring a minimal level of safety and soundness in consumer transactions.

LATE CHARGES, REGULAR BILLING, AND  
REASONABLE CONSUMERS: A RATIONALE  
FOR A LATE PAYMENT ACT

*Norman I. Silber* 855

This article considers the reasonable behavior of consumers in relation to law and the policies that tolerate the assessment of late payment penalties, fees, and surcharges. Attention is trained principally on the inadequately-regulated cycle of creditor billing and debtor repayment practices, setting aside the problem of the magnitude of late fees. It is apparent from this study that the problems associated with late fee billing cycles cut a wide swath of recurring debt repayment—telephone, electricity, and water bills, for example—and, more importantly, this article argues that the variety of different demands on consumers interacts to magnify consumer difficulties. The article then identifies some common deficiencies in legal regimes that aid and abet those who send out bills, with attention to information-processing and other cognitive difficulties that arise from the late payment regime. It evaluates existing statutory and common-law causes of action through which consumers might hope to recover from billers who intentionally or recklessly diminish the likelihood that deadlines will be met, and, in light of deficiencies, proposes a Late Payment Act which could be adopted on a state- or nationwide basis to address key shortcomings.

CARRYING A GOOD JOKE TOO FAR

*Peter A. Alces* 879  
*and Jason M. Hopkins*

Contract is predicated on agreement, or so the story goes. Of course, the reality of the modern bank-customer transaction is not so straightforward. In those transactions, the contract law is confronted with an ostensible dilemma: Should the law find its goal in the efficiency to be gained by binding customers to terms which they neither read nor understand? Or should the law instead focus on classical conceptions of bargain and agreement, and refuse to enforce contract terms that do not exhibit these characteristics? Article 4 of the Uniform Commercial Code, which regulates bank-customer transactions, attempts to strike a balance between fairness and efficiency, but the success of its task is undermined by one provision, section 4-103, which permits banks and customers to circumvent the effect of the Article “by agreement.”

The majority of the form terms that invade bank-customer agreements are not the subject of agreement in any meaningful sense; they are unilateral impositions of the “stronger” contracting party: the bank. Provisions such as waivers of a customer’s right to a jury trial and terms granting the bank the authority to alter the terms of the account agreement abound, and nobody—including the courts asked to enforce these provisions—seriously contends that these terms are the result of agreement in the sense of a bargained-for exchange. Instead, as the economic literature shows, these terms result from banks’ exploitation of their naïve customers.

In the typical bank-customer transaction, banks, like all businesses, exploit the naïveté of their less-sophisticated customers by imposing on those customers terms to which the customers have not manifested real agreement. This exploitation, which occurs even at market equilibrium, is achieved by the use of “shrouded” terms, or terms whose meaning and effect are hidden from the customer. But the impact of this shrouding is more harmful than a simple exploitation

of naïve customers: Sophisticated consumers are complicit in the bank's efforts to exploit naïve customers. Indeed, because that exploitation redounds to their benefit, sophisticated customers *seek out* banks that exploit naïve customers. A pernicious cross-subsidy results.

The extant "justifications" of unilaterally-imposed form terms such as those in bank-customer agreements miss the mark because they fail to account for that cross-subsidy. Commentators have argued that courts are capable of weeding out those shrouded terms that result in an aggregate inefficiency, or that naïve customers suffer no real detriment because they are shielded by a protective umbrella erected by the more sophisticated customers. One commentator has argued that shrouded terms are merely a prelude to later bargaining and negotiation that occurs when a customer disadvantaged by a term calls to complain about its effects. These varied attempts to craft a trust-the-market solution to the impact of shrouded terms fail because the very market that created these terms cannot be trusted to alleviate their pernicious effects.

If we cannot trust the market to police the effects of shrouded terms, then we must find some other mechanism to accomplish that task. Article 4 attempted to provide such a mechanism in the form of a laundry list of acceptable terms that would prevent banks from gaining too much power over their customers. But for those transactors that would find it advantageous to circumvent Article 4's effects, section 4-103 provided an escape clause. Now, the escape clause has become the rule rather than the exception, and a reexamination is due. The conclusion of this paper is that advertisement about the nature and impact of the terms contained in account agreements, and thus education of bank customers, can undo the harmful effects of shrouded terms. With the shroud lifted, bank-customer agreements, like any other contract, can be evaluated by reference to classical notions of bargain and agreement.

COMMENTARY: TECHNOLOGY AS THE DRIVER OF  
PAYMENT SYSTEM RULES: WILL CONSUMERS  
BE PROVIDED SEATBELTS AND AIR BAGS? *Mark E. Budnitz* 909

This commentary describes how technology has led to the development of new payment devices and systems, resulting in a complicated body of public and private payments law. In this environment, consumers have little control over how businesses and financial institutions will process their payment instruments. They are subject to adhesion contracts that contain onerous terms. Because of a lack of transparency, it is difficult for consumers to understand the legal consequences of using one payment device over another. Drawing upon the articles in this symposium, the commentary discusses how much responsibility the law should impose on consumers and how much protection they deserve. The commentary asserts that consumers have common objectives, regardless of the type of payment device they use or how it is processed. These objectives can be achieved through uniform laws that apply to all types of payment instruments and systems. Those laws should guarantee the right to error resolution, a judicial forum to hear their disputes, and a sixty-day deadline for reporting unauthorized payments.

THE ROLE OF PRIVATE SECTOR PAYMENT  
RULES AND A PROPOSED APPROACH  
FOR EVALUATING FUTURE CHANGES TO  
PAYMENTS LAW *Robert G. Ballen* 937  
*and Thomas A. Fox*

Private sector payment organizations should continue to play the primary role in establishing rights and responsibilities for payment transactions between their participating financial institutions, provided that their rules are consistent with customer protections established by federal and state governmental authorities for the customer-financial institution relationship. Current payments law structure, relying on a combination of private sector rules, baseline statutory consumer protections, and (in the case of check payments) a somewhat variable uniform check

collection statute, has shown remarkable flexibility in facilitating and responding to the unprecedented scope and pace of change that has occurred in the retail payments world over the last twenty years. The financial services industry should continue to support these two separate spheres of payment laws, private sector rules and government-mandated baseline consumer protection rules. The payment system stakeholders should not attempt to further regulate or limit, either by legislation or by regulation, the ability of private sector payment organizations to establish rules governing the relationships between their participating financial institutions.

## A REQUIEM FOR SAM'S BANK

*Ronald J. Mann* 953

This paper situates Wal-Mart's failed application to form a banking subsidiary in the context of payments policy. Generally, I argue that permitting Wal-Mart to have a bank would have a salutary effect on the relatively uncompetitive market for payment networks. The dominant position of Visa and MasterCard, in which payments are priced above cost to subsidize credit, inevitably will give way to a world in which payment services are priced at cost, or even below cost as a loss-leader to attract customers to other goods and services. Entry into this market by Wal-Mart would be likely to spur more robust competition and thus lower pricing more rapidly.

## THE KENNETH M. PIPER LECTURE

### RELIGION IN THE WORKPLACE: FAITH, ACTION, AND THE RELIGIOUS FOUNDATIONS OF AMERICAN EMPLOYMENT LAW

*Thomas C. Kohler* 975

Religion in the workplace tends to make us uneasy—an intruder in a world of Weberian rationality. Nevertheless, while relatively few of us realize it, our labor and employment law has a strongly religious foundation, without which we would have little of the legal structure with which we are familiar. In this address, I will expose this foundation, and suggest that we only fully can understand the dynamics of the law in this area in light of the religious influences that gave our law its form. Secondly, I will suggest that the crisis that employment law finds itself in—and not just in the United States—only can be addressed through a willingness to consider anew the insights religion has to offer us on the nature and dignity of work and of the humans who perform it. Lastly, I will suggest that as much as we may wish to avoid the topic, religion will force us to confront it, in the workplace, in law, and in politics. It is integral to human personality and we can ignore it only by ignoring ourselves.

## STUDENT NOTES AND COMMENTS

### IS THE ILLINOIS EQUITY IN EMINENT DOMAIN ACT TRULY EQUITABLE?

*Jedediah B. Forkner* 995

Since the Supreme Court approved of economic growth as a proper public use to support the exercise of eminent domain power to take privately-owned property in *Kelo v. City of New London*, state legislatures across the country have been reviewing and revising their eminent domain statutes. Private property owners have urged states to protect their rights by adopting a more restrictive interpretation of public use, while municipalities have argued that broad eminent domain powers allow the government to serve the best interest of the public in an efficient and cost effective manner. In Illinois, the state legislature attempted to strike a balance between these two opposing positions by passing the Equity in Eminent Domain Act. This note examines the public use provisions of the Act in light of United States Supreme Court and Illinois Supreme Court precedents, and



then suggests that a new definition of blight is required in order to ensure that the goals of the Act are accomplished.

## AN INTERNATIONAL AND ISLAMIC PERSPECTIVE OF HAMAS

*Amy Chiang* 1021

Few other groups spark as much controversy as Hamas. While it won Parliamentary elections in January of 2006, its militant tactics have earned it widespread condemnation from most of the international community. However, using international law alone will not convince Hamas to renounce violence because Hamas claims to derive its principles from Islamic law. This note explores and applies international and Islamic law to Hamas's tactics and concludes that they can both be used to convince Hamas to renounce violence and restart the peace process.

## THE FDA AND NANO: BIG PROBLEMS WITH TINY TECHNOLOGY

*Jessica K. Fender* 1063

Nanotechnology-related products and materials are becoming increasingly prevalent in our society. In the U.S., much of the burden for regulating these products falls upon the Food and Drug Administration (FDA). Thus far, the FDA has insisted that its present regulatory scheme is adequate to the task of analyzing nanotechnology products. Other administrative agencies, however, have recognized the special properties that can attach to nanosized materials. For example, the U.S. Patent and Trademark Office (USPTO) has created a special cross-reference classification: Class 977. By cross-referencing an application or a patent under Class 977, the USPTO provides strong evidence that the invention has novel, nanotechnology-related properties—yet that invention, once submitted to the FDA for approval, will be treated exactly the same as its large-scale counterpart.

This note challenges the FDA's premise that nanotechnology-related products pose no special concern by providing evidence that nanomaterials may have very different physical and toxicological properties than their large-scale counterparts. Further, many of these materials are used in products where the FDA has the weakest regulatory authority, such as in cosmetics and "generally recognized as safe" food supplements. This regulatory gap can be filled in part by making use of the USPTO's classification scheme to identify those products likely to pose special safety challenges. Once a Class 977-labeled invention is submitted to the FDA, this note argues that the product should be classified as a new product for safety and legal purposes. This would give the FDA the ability to use its labeling powers to force public disclosure of products containing nanosized material, and to strongly encourage manufacturers to engage in additional safety research. Further, this note argues that the Class 977 label should create a presumption within the FDA that the product is likely to fall within more than one regulatory category. The FDA can then use its Office of Combination Products and relevant regulations to ensure that the products receive the safety evaluation they need.